No. 10188

In the United States
Circuit Court of Appeals
For the Ninth Circuit

AMERICAN SURETY COMPANY, a corporation, and E. L. McDOUGAL,

Appellants,

vs.

THE BANK OF CALIFORNIA, NATIONAL ASSOCIATION, a corporation,

Appellee.

APPELLEE'S BRIEF

Upon Appeal from the District Court of the United States for the District of Oregon.

HONORABLE JAMES ALGER FEE, *District Judge.*

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THE BANK OF CALIFORNIA, NATIONAL ASSOCIATION, a corporation,

Appellee.

APPELLEE'S BRIEF

Upon Appeal from the District Court of the United States for the District of Oregon.

HONORABLE JAMES ALGER FEE, *District Judge.*

APPELLEE'S STATEMENT OF THE CASE

The one hundred twenty-six checks involved in this litigation bore various dates from October 2, 1935, to April 21, 1939. These checks totaled $6,562.33. The originals of nineteen of these checks, totaling $950.39, were destroyed (R. 216) by Garth L. Crowe shortly

after they were intermittently received by him each month from appellee (R. 234-5). These nineteen checks bore various dates from May, 1936, to December 5, 1938 (R. 231, Ex. 2), and the names of the endorsers on the back thereof cannot now be shown or known (R. 244-5).

During said period of more than three and one-half years Garth L. Crowe cashed the checks by forging the names of the respective payees thereon. From August, 1934, to May, 1939, he was employed by Balfour, Guthrie & Co., Ltd. (Balfour), and not by its wholly owned subsidiary, Interior Warehouse Company (Interior) (R. 311). He was paid only by Balfour (R. 311) and had his desk in Balfour's offices (R. 310). Interior did not have separate offices in Portland (R. 310). Balfour kept Interior's books (R. 252). Crowe spent most of his working time for Balfour (R. 312), although he did spend about one hour a day on Interior's business (R. 312), for which subsidiary corporation he had the titles of clerk (R. 242) and bookkeeper (R. 139).

Crowe's work and duties for Interior included the drawing of checks (R. 138-9) and having them prepared under his direction (R. 138-9, 167, 236), taking the checks to officials of Interior who were authorized to sign the same (R. 167), and accepting delivery of the same after they were signed, no one else receiving delivery immediately after the checks were signed (R. 236). He directed a girl to mail such checks as were to be mailed out (R. 237) and testified it was this re-

delivery to him which gave him his opportunity to forge the payees' names (R. 236). His work and duties for Interior also included having charge of Interior's paid checks and appellee's monthly statements concerning the same (R. 236), taking delivery of the paid checks and appellee's statements concerning them each month (R. 235, 309-10), to reconcile these bank statements (R. 237, 322), to examine paid checks and to notice the endorsements thereon (R. 307-9), and to detect forgeries on checks (R. 319). The statements read (Ex. 24), "Please examine at once. If no error is reported within ten days, the account will be considered correct."

Crowe's system of forgery over the three and one-half years involved included the addition of names to the dock superintendent's time book (R. 136, 240), to which he necessarily had access (R. 240). This was an original record book in which time of employees was entered by the dock superintendent (R. 243). His system also included the issuance of duplicate checks (R. 239, 224, 227, 228-9), the addition to the payrolls of names which did not represent then employees, i. e., either persons who had previously been employed or who never had been employed by Interior (R. 239-40, 224, 225), and the issuance of checks in the names of employees who had been paid by other means (R. 227-31). He also added to the records of the monthly summary sheets larger amounts than the dock payrolls showed were actually due (R. 248) and raised on original payrolls amounts otherwise properly due employees as shown by the dock superintendent's or the

country warehouses' time records (R. 248).

Necessarily Crowe's defalcations created actual discrepancies practically every month from 1935 to 1939 between appellee bank's monthly statements of Interior's account and Interior's own records (R. 249-50).

Interior's system and method of accounting had remained practically the same since its institution in 1900 (R. 320). Discovery of Crowe's defalcations was made in 1939. In the years prior to that time the same audit inspection was made as in 1939 without discovering the loss (R. 138). An annual audit of Interior at the instance and expense of either Interior or Balfour, was made by Price, Waterhouse & Company (R. 137). This was a limited audit each year (R. 289) based upon such an examination as would satisfy the auditors as to the substantial accuracy of the balance sheet of the subsidiary, Interior (R. 285, 289). In this respect it differed from a detailed audit (R. 288). As distinguished from this yearly audit the auditors, following discovery of Crowe's peculations, made a detailed study thereof (R. 221-232). It disclosed some direct entries in Interior's ledger (Ex. 19) which did not have supporting vouchers or support in books of original entry (R. 290).

Both Interior's dock and country warehouses furnished the original payrolls to the head office in Portland (R. 143, Exs. 21, 22 and 25), retaining carbon copies thereof (R. 144, Ex. 34). These were not inspected in the examinations for the annual audits

(R. 144). Such inspection would have shown that the nineteen forged checks listed on page 225 and the top of page 226 of the Record did not appear on the dock copy of the payroll (R. 144, 297, 303) and that only one of them appeared (R. 297, 303) on the dock time books (Ex. 23). The dock copy of the payroll was the basic record of the dock superintendent (R. 145-6). Crowe never had access to the carbons of either the country warehouse or the dock payrolls (R. 244).

Such examination would also have shown that of the twelve forged checks listed at the bottom of page 226 of the Record, only two of them appeared (R. 297, 303) in the dock time books (Ex. 23) and that of those twelve checks, two were issued in larger amounts (raised) than the amounts shown in the time books.

Such examination would further have shown that none of the thirty-seven forged checks listed on page 228 and the top of page 229 of the Record appeared on the carbons of the country warehouse payrolls which were supposed to support them (R. 282, 298-9) nor even on the original country warehouse payroll sheets (R. 298-9). It would also have shown that names had been inserted in the dock time books and erased after checks had been paid on such time (R. 301).

Except for the nine names added by Crowe to the dock superintendent's time books, none of the other checks in issue in this litigation, nor the amounts thereof nor the working time supporting the same, appeared in the dock superintendent's time books, the carbons of the dock payrolls or the carbons of the country warehouse payrolls (R. 243-4).

When Crowe took payroll checks to Interior's officials to be signed, he took the payrolls along (R. 150). These officials only checked these checks against the payrolls when signing the checks (R. 311, 323). No officer or employee of Interior ever checked the dock payrolls against the dock superintendent's time books (R. 323-4) or ever checked the paid checks against the dock superintendent's time book (R. 324). Aside from the annual audit and the payroll check when signing checks, no officer or employee of Interior ever made any check or inspection of Crowe's work (R. 321) except that:

> "Q. Did you or to your knowledge any other officer or employee of the Interior, with the exception of Price, Waterhouse, ever make any check or inspection of Mr. Crowe's work? * * *
>
> "A. A trial balance was taken off by Crowe every month and shown to the bookkeeper of Balfour, Guthrie & Company to check the control in Balfour, Guthrie's books.
>
> "Q. That was Crowe's own trial balance?
>
> "A. Yes.
>
> "Q. Was any check made back against that to see if it was proper?
>
> "A. No."

The Price, Waterhouse auditors had advised Interior that someone other than Crowe should reconcile the bank accounts (R. 140) but the Record shows that during the entire period of defalcation he was the only one who reconciled them (R. 237, 322).

One appellant, and the assignor of the other, had executed separate "loss" policies to Balfour and Interior covering these defalcations and, on the assump-

tion that an actual loss had been sustained by Interior, they paid the aggregate amount of the defalcations and the one, and the assignee of the other, seek here subrogation which was denied by the trial court. The opinion of the court below is reported in *44 F. Supp. 81.*

SUMMARY OF ARGUMENT

While specifying ten assignments of alleged error in their brief (pp. 9-14), appellants' argument is divided into but two branches, viz., whether appellee was liable to Interior, and now to appellants, for the $6,562.33 aggregate of forged checks, an aggregate of $950.39 of which have been destroyed, and whether appellants, by subrogation, are entitled to collect said larger aggregate sum from appellee.

When the insurers satisfied Interior's claim against them, they satisfied and paid the debt, which then ceased to have any existence, and without existence it did not constitute a claim to which appellants could be subrogated nor a claim which could be assigned to them. If there was a loss under appellants' "loss" policies, it could only be on the theory that appellee had paid out Interior's money and not its own money. The position of appellants in this case is exactly the reverse. They claim that in cashing the checks appellee paid out its own money and not the money of Interior.

Over the long period of time involved in this litigation Interior was negligent in failing within a reason-

able time to detect Crowe's forgeries. In this respect its system of accounting was defective or its method of operation thereunder was defective. Its failure in this respect misled appellee.

It permitted Crowe, its payroll clerk, to make up the payrolls, make up the checks, receive delivery of the executed checks for distribution, receive the paid checks at the bank and reconcile the bank statements. Interior's negligence would have estopped it from asserting the present claim, and the insurers can stand in no better position than Interior.

Appellants themselves could have sued the prior endorsers on the checks, and have no right to complain that appellee has not done so.

Where the equities are equal, or that of the defendant is superior to that of the plaintiff, or the plaintiff has merely discharged an obligation which is his own, the plaintiff cannot claim subrogation.

The proximate cause of this loss was the forging of the checks by Crowe, who was the principal in the bonds executed by these appellants. The local law requires affirmance of the judgment below.

ARGUMENT

I. ALLEGED LIABILITY OF APPELLEE

This topic is the first of the two branches of the argument in appellants' brief, and we answer it as such. They contend and cite authorities to the familiar

rule that in ordinary cases a bank is liable to its depositor when it pays out money on forged paper drawn on the depositor, on the theory that it is then paying out its own money and not that of the depositor.

The present case is not, however, an ordinary case. The facts above recited show either the use of a defective system by Interior or defective use and operation under a system, or both, and the use of either or both over a long period of time during which, as above demonstrated, a reasonable supervision over or check into Crowe's work and comparisons as between Interior's own records would have revealed the shortages caused by Crowe.

The facts show also that the two insurers executed "loss" policies in favor of Balfour and Interior, policies under which there could be no liability on the part of the insurers unless one of the insureds sustained an actual loss. The argument in the fore part of appellants' brief is, that in paying out on the forged paper, appellee paid out its own money, and not that of the insured-depositor.

WAS THERE A LOSS TO WHICH APPELLANTS COULD BE SUBROGATED OR A LOSS WHICH CREATED A CHOSE IN ACTION WHICH COULD BE ASSIGNED TO THEM?

Ever since the case of

Price v. Neal (1762), 3 Burr 354, 97 Eng. Reprint 871, 1 W. Bl. 390, 96 Eng. Reprint 221

a bank has been charged with knowledge of its depositor's signature. Therefore, if a bank pays a check upon which the depositor's signature has been forged, it has been held that it pays out its own funds, and not those of the depositor.

Likewise, if a bank pays a check upon which the endorsement has been forged, it has been held that the payment will be considered to have been made out of the funds of the bank, and not out of the depositor's account, the theory being that the bank is under implied contract to pay checks—only to persons designated by the depositor. The foregoing are the rules announced in the ordinary cases relied on by appellants.

It has been held that *in neither case is the bank permitted to charge the depositor's account with the amount of the check. Therefore, the depositor has suffered no loss to which the insurers could be subrogated, or which could be assigned to them.*

Payment by the surety to the depositor (unless the former be a volunteer; see pp. 67-8 appellants' brief, where it is stated: "In fact, unless its payment is made pursuant to an obligation it cannot be subrogated, because it would be a mere volunteer and as such not entitled to subrogation.") could only be on the theory there was a loss in that the depositor's money was paid out by the bank. The only right the depositor would have to assign to the surety against the bank would be one based on the theory that the bank has still got the depositor's money; but by payment by the

surety to the depositor they both admit, or at least claim, a loss, thereby admitting that the bank has not got the depositor's money.

The policies themselves show on their faces that they are "loss" policies and not "liability" policies.

> R. 179-80. "* * such pecuniary loss as the Employer shall have sustained * *"
>
> R. 189 "This policy is to indemnify the Assured for any loss they may sustain * *"
>
> R. 197. "Please pay all losses for our account to Messrs. Gardner, Mountain & D'Ambrumenil Ltd.
>
> Balfour, Guthrie & Co., Limited * *"
>
> R. 200. "This Policy is to indemnify the Assured for any loss they may sustain * *"
>
> R. 205. "* * to pay or make good * * all such Loss or Damage as aforesaid as may happen to the subject matter of this Insurance * *"

The principle of election of remedies is so closely associated with the principles just discussed as to make it proper to treat them together.

ELECTION OF REMEDIES

The depositor has two separate remedies: (1) to deny the bank's right to charge the forged checks to the depositor's account, thereby claiming that the checks were paid with the bank's own money and not out of the account; (2) to make claim against the surety, thereby admitting, or at least claiming, that the checks were paid with the obligee's money.

These two positions are inconsistent and antagonistic.

9 C.J.S. 752

> "A plaintiff who sues a drawee bank on a check paid by it on a forged indorsement takes the position that the bank still has his money, that the money paid out by the bank was the bank's money, and that such payment was not binding on plaintiff; and, where he sues another who has indorsed such check over to the drawee bank, he necessarily takes the position that the money paid by the drawee bank was wrongfully paid and, therefore, wrongfully detained. Such positions are mutually contradictory, and in choosing his remedies plaintiff cannot adopt both positions."

In the first remedy the bank suffers the loss and in some cases would be entitled to take an assignment against the surety which would then defend an action by the bank.

In the second remedy the surety would suffer the loss and, if it took any assignment against the bank, the latter would be obliged to defend.

National Surety Co. v. Perth Amboy Trust Co. (1935 3 C.C.A.) 76 F. (2d) 87, 90

> "The right of action which Chase at one time may have had against the Trust Company arose out of its liability to make good to the Insurance Company its losses and out of the Trust Company's guaranty of endorsements. But when the Insurance Company elected to sue Peterson (long before it was indemnified by the Surety Company) it lost its right to sue Chase and, through Chase, a right to sue its forwarding banks. Chase had not then (so far as we can learn from the record) made good the losses nor was it thereafter liable to an action by the Insurance Company; hence it no longer had a right of action against the Trust Company on its guaranty of endorsements

to which the Surety Company could be subrogated.

* * * *

"The claimed right of action of the Surety Company as assignee of Chase ,which is very much the same as its claimed right of subrogation from Chase is based on the right of action which Chase perhaps originally had against the Trust Company on its guaranty of endorsements and on its liability to pay the Insurance Company for its losses. But Chase was relieved of its liability for honoring checks with forged endorsements and therefore lost its right of action against the Trust Company when the Insurance Company elected to sue Peterson for conversion, which was nearly a year before the Surety Company indemnified the Insurance Company under the forgery bond. Being thus relieved of its liability to the Insurance Company and, in consequence, not having suffered any loss for honoring checks with forged endorsements, and not being liable to suffer any loss in the future, Chase did not have, when it assigned its rights of action to the Surety Company, any action or right to sue the Trust Company on its guaranty of endorsements."

Midland Savings & Loan Co. v. Tradesmen's Nat. Bank (1932 10 C.C.A.) 57 F. (2d) 686, 693 (cert. denied 77 U.S. (L. Ed.) 334)

"It appears, however, that as to certain of the checks the Midland Company pursued Dewberry either by making a claim against his estate or accepting relief as against Dewberry and his estate. If this was done subsequent to the time the plaintiff acquired actual knowledge, as distinguished from suspicion, that Dewberry had forged the indorsements, or if the relief asked for or accepted was grounded upon the fact of his forgery, then under the rule laid down, supra, it elected to treat the entire proceeds of such checks as lawfully coming into his possession, and thereby ratified the act of the bank in paying out its money."

United States Fidelity & Guaranty Co. v. Fidelity Nat. Bank & Trust Co. (Mo. 1937) 109 S.W. (2d) 47, 49

"When Continental obtained full knowledge of all the facts of Chaney's forgeries and embezzlement, including the nature and amount of its loss, which it did prior to January 15, 1931, it had open to it two remedies. It could have demanded payment of its money from defendant on the theory that when defendant paid the checks on forged indorsements of Chaney the bank paid out its own money and not that of Continental. Since defendant had received Continental's money on deposit and had never been legally authorized to pay it out, it still had Continental's money and must account to Continental therefor. (Citing authorities.) Or it could have affirmed the act of the bank in paying out the money on a forged indorsement and, upon the theory that Chaney had its money, it could have pursued Chaney and sought and obtained the return of its money embezzled by him. (Citing authorities.)

"The two theories are inconsistent with each other. See above citations, especially the last two in the preceding paragraph. On January 15, 1931, either defendant had Continental's money and was liable to it for money had and received, or Chaney had it and was liable for money had and received. Obviously, both could not have the same money at the same time. * * * Thus it will be seen that Continental took the position that Chaney had its money, demanded return of same from him, and claimed that he had converted it to his own use. Failing to get it from Chaney, it made demand upon Chaney's bondsman, plaintiff, who had contracted with Continental, for a consideration, to indemnify the latter for any loss occasioned by Chaney's embezzlement. Chaney could not be liable to Continental upon any theory of embezzlement unless the money alleged to have been embezzled was the property of Continental. That is hornbook law.

"When Continental, in possession of all of the facts, made demand, and when plaintiff, fully advised of the facts, paid the loss it had contracted to pay, the election of Continental was completed. Continental could not thereafter assert its claim against defendant, and, by no theory of reason or logic can plaintiff be in a better position than Continental in this respect."

Union Guardian Trust Co. v. First Nat. Bank-Detroit (1935 Mich.) 259 N.W. 912, 915

"On either theory recovery in the former case was necessarily based upon the fact that Josephine had the money belonging to the estate. If she had it, of course the bank did not have it. Therein lies the inconsistency between the former case and the present suit at law in so far as recovery is now sought on the basis of a contract obligation. Recovery ex contractu cannot be had in the instant case except upon the theory that the bank has in its possession the money deposited with it by Mary Jozefiak. Such an assumption is wholly inconsistent with the theory upon which the estate was decreed relief in the chancery suit. Because plaintiff previously elected between inconsistent remedies, it cannot recover on the ground of a contract obligation in the instant case."

Insurance Co. of North America v. Fourth Nat. Bank (1928 5 C.C.A.) 28 F. (2d) 933, 935

"Some adjustment of that suit was made by which it is stated, and not denied, that the plaintiff received certain property and funds from Cain and his wife, but the suit was not dismissed, no doubt because of the subsequent bringing and pendency of the present action. In such circumstances, we think the lower court was correct in holding that the plaintiff had made an election to pursue the property and funds in the hands of its agent, and could not thereafter maintain its claim for money had and received against defendant."

Kaszab v. Metropolitan State Bank (1932) 264 Ill. App. 358

In an action by depositor in Greenebaum Savings Bank & Trust Co. against a bank through which checks with forged endorsements of payee had cleared, a plea was made that depositor had previously sued drawee bank and lost. The plea was held good, the court at pages 362-3 saying:

> "In other words, that the plaintiff, by his action against Greenebaum, refused to ratify the act of Greenebaum in paying the Metropolitan State Bank, but, by his action against Metropolitan State Bank he thereby took an inconsistent position in that he must necessarily ratify the action of Greenebaum Savings Bank & Trust Company in paying the defendant.
>
> "Courts of law are open to litigants to furnish redress for injuries or damages sustained, *but it places upon the litigant the duty of electing the course he desires to pursue. If the actions are inconsistent, the courts place the responsibility of election on the one who seeks its aid and assistance."* (Italics ours.)

This case was followed in

Golinkin v. First Union Trust and Savings Bank (1934) 276 Ill. App. 40, 42.

So in the case at bar the depositor had a choice upon discovering the alleged perfidy of its bonded employee, to disaffirm his action in endorsing the payees' names and to say to the bank that the bank had paid out its own money, and still had the depositor's money. Or it could affirm his act and look to the sureties, saying in effect to them that its employee had breached their

fidelity bonds and had embezzled its money. The depositor elected the latter remedy, filed its proof of loss which the sureties approved and paid.

It was obviously impossible for the money paid out on the checks to have been the money of the depositor for the purpose of securing speedy reimbursement from sureties, and the money of the bank for the purposes of the present suit. If the sureties intended to look to the bank and felt the bonded depositor had not been guilty of negligence in relation to the employee and the supervision of the bank account and returned vouchers permitting a recovery against the bank, they were obligated to refuse payment and advise the depositor that in fact and law it had suffered no loss and had no claim.

To relieve themselves of a part, at least, of their liability for the loss of insured property, brought about by the fault of a common carrier, insurers have used various contractual provisions. It is usual for carriers, in order to escape the loss, to insert in their bills of lading a provision that the carrier shall, in case of loss or damage to goods, have the benefit of any insurance effected on the goods. By such provision a payment by an insurer to the shipper would discharge, pro tanto, the latter's claim against the carrier and, such claim being discharged, there would obviously be no right of subrogation in the insurer of any right against the carrier.

To escape this consequence the insurers conceived the idea of making a loan to the insured, pending set-

tlement with the carrier, upon condition that it should be repaid to the extent that a recovery was obtained from the carrier.

Appellants could have made payment to Interior Warehouse Company in this case by means of a loan receipt and thereafter suit could have been brought in the name of the depositor. This method was approved in the case of a casualty payment in

> *Edgar F. Luckenbach v. W. J. McCahan Sugar Refining Company* (1918) 248 U.S. 139, 39 S. Ct. 53, 63 L. Ed. 170.

But the sureties in the case at bar realized the negligence of the depositor in said particulars extended over many years; that there had been an apparent embezzlement, and they, therefore, approved and paid the claims. They now seek subrogation to specious rights which their insured, with all the facts before it (and with their approval), renounced, electing instead the theory that affirms the loss as the depositor's loss and the cashing of the checks as the embezzlement of the depositor's money—not that of the bank. The remedies, being inconsistent and each mutually destructive of the other, cannot in the nature of things be successively pursued—one by the depositor, the other by the sureties as a salvage attempt. Subrogation certainly cannot place the sureties in the shoes of the depositor as of a date prior to the election, but after and subject to the incidents of the election.

Tacit admission of the foregoing was made by one of appellants' attorneys at the trial below when he said:

> R. 344-5 "I will say that there is some authority to the contrary, but whatever authority there is to the contrary, I can only reconcile it on this theory, that if we sue the endorser we certify the payment that the bank made, and so even on the theory of those who say we can sue such a person who gets it from the bank, if we did go after him it would be on the ground that we are abandoning any action that we have against the bank. * *"

The sureties could also have sued for a declaratory judgment.

II. APPELLANT'S ALLEGED RIGHT TO SUBROGATION

The opinion of the court below (*44 F. Supp. 81, 85*) upon which its findings and conclusions are based distinguished the case of

United States Fidelity Co. v. United States National Bank (1916) 80 Or. 361, 157 Pac. 155

upon which appellants so largely rely, and applied the law of the later case of

American Central Insurance Co. v. Weller (1923) 106 Or. 494, 212 Pac. 803

In the United States Fidelity Co. case the bank, after the depositor had exhausted his individual account, still honored his overdrafts on his individual account and charged them to his guardianship account. On page 157 the court said that the defendant:

> "* * extended credit to Bridges on his individual overdrafts and immediately appropriated the money of others to their payment."

and further held that the defendant bank was in effect a joint tort-feasor.

The Weller case is digested on pages 85 and 87 of *44 F. Supp.* by Judge Fee. The Weller case was heard in banc. Six judges concurred; one dissented. The case held that the insurer's payment to the bankers of the amount due on the automobile conversion policy satisfied the debt in that amount as against defendant, the guarantor of the debt by a separate and different contract. The court reviewed authorities allowing subrogation against third parties whose wrongful acts caused the loss and concluded on p. 807 of *212 Pac.*:

> "Weller as guarantor comes within the class that should be relieved under the rule mentioned. No one but the creditor, Ashley & Rumelin, could ask him to pay. When the insurance company paid the $300 on the policy the debt was satisfied to that amount as to Weller, and could not be assigned."

Crowe was the principal on these surety bonds, whether he signed them as such or not. By those bonds the insurers bound themselves to answer to Interior for Crowe's defaults. Interior was the obligee-creditor, Crowe its bonded employee and the American and Lloyd's were the obligors-insurers-sureties.
Arant on Suretyship, p. 11

> "The principal is the person for whose debt or default the surety or guarantor is liable. * * The principal is the person whose performance of duty is secured by the surety's promise. He is under a duty so to perform that the surety will not be molested by the creditor. In case the surety is required to pay, the principal is generally under a duty to reimburse him."

The American's policy provided (R. 180):

> "* * * through the fraud, dishonesty, forgery, theft, embezzlement, wrongful abstraction or wilful misapplication * * *"

The Lloyd's policy provided (R. 189):

> "* * * by reason of infidelity or dishonesty of any or all of their employees * * *"

In

Baker v. American Surety Co. (1916) 181 Ia. 634, 159 N.W. 1044, 1046

the defaulting treasurer of a union had been bonded by one of the appellants in the case at bar, the language of the bond (*159 N.W. 1045*) being similar to its bond which is involved in the case at bar. The treasurer forged checks of the union, or endorsements thereon, and the union sued on the bond. The defendant surety attempted to bring the union's bank in by cross-petition. In ruling that the allegations of the cross-petition did not entitle the surety to subrogation in the event it be required to pay the union's loss, the court said at p. 1046:

> "If the surety is adjudged liable thereon and pays the alleged loss occasioned by Brown's dishonesty, it will merely pay Brown's indebtedness and not that of another, even though the other may also be liable therefor. At the most it is a case where each of two parties may be held for the dissipation of the same moneys, the bank because of paying out without authority, and the other fraudulently inducing the bank so to do. In such a case both are absolutely and neither entitled to subrogation, for either in paying is satisfying his own indebtedness. But the bank on payment undoubtedly could recover over from the wrongdoer. Moreover, the equities of the surety upon

> payment would be measured by those, if any, existing in behalf of its principal, Brown, and, as between Brown and the bank, all are in favor of the bank, and under the rules stated subrogation must be denied. Otherwise the forger or his surety would be preferred to the one swindled by his forgeries."

Clearly Crowe is under a duty to reimburse the American and Lloyd's. Clearly no duty on the part of Interior was secured by the sureties' promises. The default of Crowe, the American and Lloyd's principal, was the proximate cause of the loss and, having paid the loss occasioned by the acts of their principal, the loss must fall upon them.

American Bonding Co. v. Welts (C.C.A. 9th) 113 C.C.A. 598, 193 Fed. 978, 980, 981

Here the plaintiff bonded a defaulting county auditor, paid the amount of the default to the county, and brought this action against the county treasurer, who cashed the defaulter's fraudulent warrants, and the county commissioners, who allegedly could and should have stopped the fraud. Judgment for the defendants was affirmed by Judges Gilbert, Wolverton and Ross, the latter stating:

> "From the averments of the bills in these cases it is clear that the proximate cause of the county's loss and of the resultant loss to the appellant was the malfeasance of the auditor, for whose official honesty and faithfulness the appellant had bound itself. * * *
>
> "What duty or obligation did the appellees or either of them assume towards the appellant in or

> by the bond executed by it to Skagit county? None such are alleged in either of the bills, and none such are suggested, or can be suggested, by appellant's counsel, since no such duty or obligation existed. The fact that the treasurer and commissioners of the county had other and distinct duties required of them by law for the faithful performance of which they, too, were required to give bonds to the county did not enter into the considerations for and upon which the appellant's undertaking was executed."

In

National Surety Co. v. Arosin (C.C.A. 8th, Minn.) 198 Fed. 605, 609

the plaintiff, surety on the bond of a defaulting county auditor, sought to recover the amount of the default on false redemption warrants from Arosin, who was the county treasurer, the surety on his official bond and a bank which paid the warrants on forged endorsements. In affirming a decree for these defendants on these warrants the court said:

> "The plaintiff seeks to hold the defendant Arosin and the defendant and appellee the United States Fidelity & Guaranty Company surety on Arosin's official bond, on the ground that the law required the treasurer to pay only by check and that when he made some payments to Bourne in cash over the counter he violated this law.
>
> "It seeks to hold the National German-American Bank on the ground that it wrongfully paid out money of the county on forged indorsements.
>
> "The same rule, however, must be applied to these three defendants as was applied to the State Savings Bank. The primary cause of the loss was the manufacture by Bourne of the false warrants and orders. For his official misconduct the plaintiff was liable."

United States Fidelity & Guaranty Co. v. Title Guaranty & Surety Co. (D. Ct. Md.) 200 Fed. 443, 447, 448, 449

Plaintiff surety bonded a bank to secure repayment of the state's deposits to the latter. Defendant surety bonded the state treasurer. When the bank failed plaintiff paid the state the amount of its deposit and brought this suit to recover that amount from defendant on the theory that the state treasurer had made the deposit in violation of law. In sustaining a demurrer to the bill the court said:

> "There is but one question to be considered. Is there any reason why, in a court of conscience, the respondent should be required to make good complainant's loss? * * * If the state had not already been reimbursed by complainant, it could compel the respondent to make good its loss. If the state could do so, the complainant says it can, because it is subrogated to the state's rights. That does not necessarily follow. * * * When it is sought to exercise the right of subrogation, something more must be shown than that the defendant could have been compelled by the principal creditor to pay the debt to it. It must appear that, as between complainant and respondent, it is the latter and not the former which in equity should bear the loss.
>
> * * * *
>
> "Either surety could have held both or either of the principals for anything it had been compelled to pay in consequence of their breach of law. Under such circumstances the loss must fall upon *that one of the sureties whose principal's default was its proximate cause.*" (Italics ours.)

To the same effect are:

Commonwealth v. Farmers Deposit Bank (1936) 264 Ky. 839, 95 S.W. (2d) 793, 795-6.
United States Guarantee Co. v. Elkins (C.C.A. 3rd, 1939) 106 F. (2d) 136, 137.

This is not the usual case where the surety, having paid the amount of the principal's debt, seeks subrogation to the rights of the obligee against the principal. Nor is it a case where a surety or an insurer, upon paying the loss, seeks subrogation against a third person on the theory that the third person is a wrongdoer or defaulter or that he stands in the shoes of the wrongdoer or that he is primarily responsible for the wrong or default. Cases like such a case are relied upon by appellants on page 43 and elsewhere in their brief. We cannot distinguish them better than did Judge Fee in *44 F. Supp. 85,* where he said:

> "These decisions neglect consideration of the fact that the forger is the only wrongdoer in the situation. Likewise, they neglect consideration of the highly equitable nature of subrogation."

In the present case the insurers, after sustaining the very loss they contracted and were paid to sustain, seek to recover the same from the appellee which, as to them, is an innocent third party. When a surety attempts to be subrogated to the rights of a creditor against third persons, who, on account of their relationship to the transaction in question, might be legally liable to the creditor but who are, in fact, innocent of any misconduct or negligence, the surety cannot recover.

WHERE EQUITIES ARE EQUAL OR DEFENDANT'S EQUITY IS SUPERIOR TO PLAINTIFF'S, PLAINTIFF CANNOT HAVE SUBROGATION.

Where the equities are equal, or where the defendant's equity is superior to that of the plaintiff, or where the plaintiff has merely discharged an obligation which is his own, the plaintiff cannot claim subrogation.

Commercial Cas. Ins. Co. v. Petroleum Pipe Line Co. (C.C.A. 10th, 1936) 83 F. (2d) 412, 414

> "It is well settled that the right of subrogation does not obtain in favor of one who discharges a debt in the performance of his own obligation, nor where the equities are equal."

Amick v. Columbia Casualty Co. (C.C.A. 8th, 1939) 101 F. (2d) 984, 986

> "Subrogation is enforced only in favor of a superior equity."

American Surety Co. v. Citizens' Nat'l. Bank (C.C.A. 8th, 1923) 294 Fed. 609, 616

> "The right of subrogation is an equitable right, and where equities are equal the right does not exist and there can be no relief."

Southern Surety Co. v. Tessum (1929) 178 Minn. 495, 228 N.W. 326, 329-30.

In this case two guardians for an incompetent executed separate bonds with separate sureties thereon. Plaintiff, as one of such sureties, paid for a conversion by its principal and sued the other guardian and his

surety, contending that if it had not paid, the creditors could have sued defendant and his surety and recovered, and that plaintiff should now recover as subrogee of that right.

The court held otherwise, holding that even if the equities were equal, plaintiff could not prevail.

Appellants, on pages 46-9 of their brief, say that appellee's cases involve bonds protecting public officials and that in such cases the bond protects third persons from loss on account of official misconduct of the principal. Some of appellee's cases were of that character because the principle therein stated is the general principle, but many of the cases laying down the same principle do not involve bonds of that character.

In addition to the foregoing authorities, we draw the court's attention to these cases:

In

Meyers v. Bank of America (1938) 11 Cal. (2d) 92, 77 P. (2d) 1084

plaintiff's office manager had forged plaintiff's name on checks payable to plaintiff and had negotiated them to defendant Wascher, who deposited them in his account in defendant bank, which collected the checks from the drawers. Plaintiff's insurer paid him the amount of the defalcations and took an assignment which included the right to sue in plaintiff's name. The plaintiff sued for his assignee, and judgment for him was reversed, the court stating on page 1089:

> "As stated hereinbefore, the right to maintain an action of this kind and to a recovery thereunder involves a consideration of, and must necessarily depend upon the respective equities of the parties. Here, the indemnitor has discharged its primary contract liability. It has paid what it contracted to pay, and has retained to its own use the premiums and benefits of such contract. It now seeks to recover from the bank the amount thus paid. It must be conceded that the bank is an innocent third party, whose duty to the employer was based upon an entirely different theory of contract, with which the indemnitor was not in privity. Neither the indemnitor nor the bank was the wrongdoer, but by independent contract obligation each was liable to the employer. In equity, it cannot be said that the satisfaction by the bonding company of its primary liability should entitle it to recover against the bank upon a totally different liability. The bank, not being a wrongdoer, but in the ordinary course of banking business, paid money upon these checks, the genuineness of which it had no reason to doubt, and from which it received no benefits. The primary cause of the loss was the forgeries committed by the employee, whose integrity was at least impliedly vouched for by his employer to the bank. We cannot say that as between the bank and the paid indemnitor, the bank should stand the loss."

Over pages 1086-1089 of the Meyers case opinion the court reviewed at length eight cases which support the opinion and cited with approval an additional eight cases which support it.

The Meyers case was cited with approval and followed in:

Jones v. Bank of America (Cal. App. 1942) 121 P. (2d) 94, 98-9.
State Bank v. Billstrom (Minn. 1941) 299 N.W. 199, 203.

National Surety Corporation v. Edwards House Co. (Miss. 1941) 4 So. (2d) 340, 341.

New York Title & Mortgage Co. v. First National Bank (C.C.A. 8th Mo.) 51 F. (2d) 485, 487 (cert. denied, 284 U.S. 676, 76 L. Ed. 572, 52 S. Ct. 131)

In this case the title company had issued title policies to a loan association, guaranteeing the association against loss by reason of defects in titles to mortgaged real estate. The loan association issued its checks, naming as payee the person who was supposed to own the property and to have signed the mortgages, but the mortgages were forgeries as were the notes secured thereby. The checks were delivered to a loan broker who purported to be an agent of the mortgagor, but who was in fact the person who was guilty of forging the mortgages and notes. This loan broker, in turn, forged the name of the payee on the checks, deposited them in his own account at the bank, and converted the proceeds. The title company reimbursed the loan association and brought suit against the bank on which the checks were drawn.

In deciding the case in favor of the bank the court held that satisfaction of its liability by the title company would not give rise to a right to recover against the bank under the doctrines of subrogation, stating on page 487:

> "It is doubtful whether the mere fact that the loan company may have had two sources to which it might look for reimbursement would confer on the plaintiff the right of subrogation as to one of such sources. If we assume that neither the plain-

tiff nor the bank was the wrongdoer, but, by independent contract obligation, each was liable to the loan company, then the satisfaction of such primary liability by the plaintiff would not give rise to a right to recover against the bank under the doctrine of subrogation, the bank not being a wrongdoer. * * *

"But if there were any doubt as to the soundness of this position, we think it clear that plaintiff is not entitled to invoke the remedy of subrogation, because that right is an equitable one, and is applicable in cases in which one party is required to pay a debt for which another is primarily answerable, and which, in equity and good conscience, ought to be discharged by the latter. It is the method which equity employs to require the payment of the debt by him who in good conscience ought to pay it, and to relieve him whom none but the creditor could ask to pay. It cannot, as a matter of right, be invoked in all cases without regard to circumstances, but only in cases in which justice demands its application, and the rights of one asking subrogation must have a greater equity than those who oppose him."

Washington Mechanics' Savings Bank v. District Title Ins. Co. (Ct. Appeals D.C.) 65 F. (2d) 827, 830

Here a check was prepared and signed by the title insurance company and placed in a file for future use. It was stolen from the file by an employee of the drawer who forged the name of the payee and deposited the check bearing the forged endorsement in the employee's account at the defendant bank. The defendant bank collected the proceeds from the drawee bank and the check in due course was returned as a canceled check to the drawer. The drawer was protected by a fidelity bond covering the dishonest employee and col-

lected under that bond. The drawer then instituted suit against the collecting bank.

The court held that the drawer, in the absence of insurance or indemnity, would have been entitled to recover from the collecting bank, but that having been paid by the indemnity company, the right to recover depended upon whether the indemnity company was entitled to subrogation. In reversing a judgment against the bank the court said on page 830:

> "We are unable to see any particular in which the equities of the bonding company are superior to those of the appellant bank. Neither one was guilty of culpable negligence in the transaction. The bonding company, being in the business of guaranteeing for a consideration the faithful conduct of employees, enabled the defaulting employee to hold the position of trust which he occupied. The appellant bank was acting consistently with the ordinary course of banking business in accepting a check, whose genuineness it had no reason to doubt. It cannot be said that either one of these parties, as compared with the other, was primarily liable for the default. It follows that the equities of neither are superior to the equities of the other in the transaction. It appears that, had the appellant bank paid the loss to the title companies, it would not have been entitled to recover from the bonding company by reason of subrogation, nor is the bonding company entitled by subrogation to recover from the appellant bank."

American Bonding Co. v. First National Bank, 27 Ky. L. 393, 85 S.W. 190

Here plaintiff had executed a fidelity bond covering an employee of an ice company who appropriated

his employer's money by means of raised checks. Upon paying the loss plaintiff brought this suit to recover from the bank which cashed the checks. In affirming dismissal the court said:

> "It appears that the appellant, for a valuable consideration, had guaranteed the fidelity and honesty of the agent, Weitkamp—in other words, had become his surety—and had agreed, for this consideration, to pay any losses sustained by reason of the dishonesty of Weitkamp. In view of these facts, we cannot understand upon what principle of equity the appellant here is entitled to be subrogated."

ASSIGNMENT INEFFECTUAL

Appellant American claims only subrogation. Appellant E. L. McDougal claims under an assignment from Lloyd's (Ex. 14). The assignment to appellant McDougal adds no strength to his position. Even if he had an assignment from Interior, or an assignment from Lloyd's after Interior had assigned to it, it would add nothing to his rights here.

National Surety Co. v. Perth Amboy Trust Co. (C.C.A. 3rd) 76 F. (2d) 87, 90.
Meyers v. Bank of America, 11 Cal. (2d) 92, 77 P. (2d) 1084, 1086.
Louisville Trust Co. v. Royal Indemnity Co., 230 Ky. 482, 20 S.W. (2d) 71.
American Surety Co. v. Lewis State Bank (C.C. A. 5th) 58 F. (2d) 559, 560-61.
American Bonding Co. v. State Savings Bank, 47 Mont. 332, 133 Pac. 367, 368.

DEPOSITOR'S NEGLIGENCE

In our statement of facts we delineated the responsibilities of Crowe, the clerk in charge of Interior's records, including the payrolls. We have shown how, over the three and one-half years the forgeries were taking place, Interior by consultation of its own records could have, with the exercise of reasonable diligence, discovered the fraud. To these various elements should also be added the further facts that on a number of the one hundred seven checks, the originals of which were introduced in evidence, Crowe, after forging the payee's name, endorsed his own, and that there is much repetition in the names of the various payees. These are additional factors in determining Interior's negligence. Under all of these circumstances the appellants are not entitled to recover here.

Young v. Gretna Trust & Savings Bank (1936) 184 La. 872, 168 So. 85, 89-90.

was a suit by the receivers of the employer to recover $30,052 abstracted over a period of almost five years in the form of checks from $2 to $20 bearing the forged names of payees. A clerk, assistant to the timekeeper, helped in making up payrolls from time cards and in making up part of the checks. He made false time cards and punched them to show time allegedly due. He substituted false payrolls, based on these time cards, in place of the true. He used practically the names of the same individuals as payees. The court said:

"The Gretna Bank cashed the checks in question in the usual, ordinary manner, in good faith, and in due course of business. The evidence shows that none of the checks were cashed at the window of the Gretna Bank, but were all cashed by a Mr. Gerstner and a Mr. Wakefield, handbook operators, who subsequently cashed the checks at the various New Orleans banks, which sent them to the defendant for payment upon their respective indorsements thereof. Plaintiff's checks, after payment and cancellation, were returned to it monthly, together with a statement and notation thereon to please examine at once, and if no errors were reported in ten days, that the account would be considered correct.

"The fact that plaintiff, through its authorized officers and agents issued to designated parties these checks, which appeared on their face to be regular payroll checks, justified the defendant in believing that the payees thereof were regular employees of plaintiff and the indorsements thereon genuine. Moreover, the repeated issuance of the checks in the manner herein pointed out from week to week and year to year, and particularly during the last two years when the checks were made payable to the same named twelve employees, was not only sufficient to induce a cautious and careful person to believe and conclude that such checks were issued to plaintiff's bona fide employees and the indorsements thereon were genuine, but would also tend to place the bank in such a position that it could be imposed upon by plaintiff's trusted officer.

"The record conclusively shows that during the entire period during which the checks were fraudulently issued and cashed through Vanderbrook's manipulations, neither plaintiff's officers nor its employees ever made a single check of its payroll against the men actually employed or against the labor records. Plaintiff's own witnesses testified that had such a check been made, it would have

revealed Vanderbrook's fraud.

> "A well-established rule of equity is applicable here, i.e., that 'where one of two innocent parties must suffer loss through the fraud of another, the burden of the loss should be imposed on him who most contributed to it.' * * *
>
> "We are of the opinion that under the facts and circumstances of this case the carelessness, negligence, and laches of the plaintiff are the direct and proximate cause of the loss, and, therefore, it is estopped from claiming reimbursement from the Gretna Trust & Savings Bank, in liquidation."

The situation in

Defiance Lumber Co. v. Bank of California, N.A., (1935) 180 Wash. 533, 41 P. (2d) 135, 140

was much the same as in the case last cited. It involved the manipulation of time clocks and the cashing of the forged checks at different places. The court concluded:

> "We are clearly of the opinion that appellant, by its careless and negligent conduct of its own business, permitted its own employee to perpetrate upon it a gross fraud, and that it cannot now recoup its losses by passing the burden thereof to respondent. Appellant set up the machinery which resulted in the loss, itself took into its employ the man who stole its money, continued him for a long period of time in a position of trust and authority, failing to observe, as we view it, the slightest care to see that it was protected against such fraud as was in fact perpetrated, either by some reasonable check of its employees, by adequately guarding its time clock or its time cards, or by maintaining an adequate system of accounting by which any such loss as that which occurred would have been avoided."

And the court also stated:

> "The rule that a bank which pays a check upon a forged indorsement must stand the loss is limited to instances in which the acts of the depositor have not increased the risk lawfully resting upon the bank. The equitable doctrine that, as between two innocent persons, the one whose act was the cause of the loss should bear the consequences, applies in many cases. * * * Manifestly, * * * no specific rule can be laid down as to just what conduct on the part of the drawer of a check will constitute negligence sufficient to preclude him from holding the drawee bank liable for paying his check upon a forged indorsement; each case depending upon its own circumstances."

In the case of

C. E. Erickson Co. v. Iowa Nat. Bank (1930), 211 Iowa, 495, 230 N.W. 342, 344

where the facts showed that payroll checks were fraudulently procured by an officer of the drawer, payable to former employees, and paid by the drawee bank upon the forged endorsement by the officer of such employees' names, the court said:

> "If the drawee-bank in paying the check reasonably believed that the payee was a present employee, it might also reasonably believe that the indorsement was genuine. In such event the plaintiff would be chargeable with negligence in inducing the belief. * * * If in this case the representations of fact made on the face of the checks by Bridges, as the signer thereof, might reasonably be relied upon by the drawee, and if when so relied on they reasonably tended to relax further investigation on the part of the drawee, for its own protection, then they worked an estoppel against the plaintiff."

In the case of

Kaszab v. Greenebaum Bank & T. Co., (1929) 252 Ill. App. 107, 114

where an employee padded his employer's payroll and cashed checks made payable to persons not in its employ, upon the forged endorsements of the names of such persons, it was held that the fact that the employee continued to forge endorsements for a period of nineteen months, during which time he cashed four hundred sixty-eight checks without being detected although monthly statements were furnished by the bank to the plaintiff, required the submission of the question of the employer's negligence to the jury.

In that case the appellate court of Illinois said:

> "Banks deal with a great number of depositors and, while they owe an obligation to their customers, nevertheless, in view of the great number of transactions carried on in the course of a banking day, it becomes incumbent upon the depositor to assist by exercising some sort of supervision over his own individual account. It is not fair to the bank for such a depositor to ignore his own responsibility and rely solely upon the diligence of the institution with which he is doing business. This would appear to be particularly true where the depositor is in a better position to discover the fraud practiced upon him through the agency of an employee closely associated with and under his direct supervision and control."

United States v. Citizens Union Nat. Bank (D. Ct. Ky., 1941) 40 F. Supp. 609

Here the court, commenting on a Kentucky case holding that the drawer of a check was precluded from setting up forgery of the payee's name against the de-

pository bank where the drawer's own acts and conduct invited the forgery and made it possible, quoted therefrom as follows:

> "The exception to the general rule springs from the just and equitable principle recognized in all jurisdictions that, where one of two innocent parties must bear a loss, it must be borne by the one whose conduct made it possible."

In the case of

Royal Indemnity Co. v. Federal Reserve Bank (D.C. Ohio, 1939) affirmed on District Judge's opinion in 119 F. (2d) 778, 38 F. Supp. 621, 623

the court, in commenting upon the cashing of forty-seven checks by the insured's agent forging the names of the payees thereon said that the insured, in permitting its agent to deliver checks, and in its failure to compare the purported signatures of payees with genuine signatures in its possession, was careless and negligent and therefore directly responsible for the forgeries. Recovery by the insured's surety against the bank was denied.

In addition to those of the above quotations which deal with the depositor's duty to examine and audit his bank account see:

Mattison-Greenlee Service Corporation v. Culhane (1937 D.C. Ill.) 20 Fed. Supp. 882, 886

where it is stated:

> "A depositor owes his bank the duty to examine the statements of his account furnished him by the bank and report errors which he discovers or ought to discover therein without unreasonable delay. A depositor is charged with

notice of what a reasonable examination would reveal. When a depositor's agent, permitted to examine the bank statements, is the same person who embezzled from the depositor's account, the federal cases do not for that reason absolve the depositor. The latter, it is true, is not charged with the knowledge which his dishonest agent has, but he is charged with knowledge of such facts as a reasonable examination by an honest agent would disclose. * * *

"The general rule is that a depositor is charged with knowledge of such facts as a reasonable examination by an honest agent would reveal."

This rule is reflected in

England National Bank v. United States (1922 C.C.A. 8th) 282 Fed. 121, 126-7 (opinion by Justice Sanborn)

"It is the duty of a depositor, who receives such a statement and such paid checks, within a reasonable time to examine them, to ascertain whether or not the account is correct and whether or not the paid checks are just and legal vouchers for the amounts charged on the account of them, and, immediately upon the discovery of any error in the account, or any fraudulent altered or defective paid check or voucher, to notify the bank thereof, in order that it may at once proceed to protect itself before others exhaust the property of the wrongdoer who caused the loss; and the negligence or failure of the depositor to make the examination within a reasonable time, or speedily to notify the bank after his discovery of an altered, defective or fraudulent check or voucher, is in law a conclusive admission of the correctness of the account and the legality and justice of the vouchers, upon which the bank has the right to rely, and which the depositor may not consequently deny."

See also:

General Cigar Co., Inc. v. First Natl. Bank of Portland, Or. (C.C.A. 9th, 1923) 290 Fed. 143, 146.

PRIOR ENDORSERS

Appellants complain in their brief that appellee did not bring in the endorsers of the checks by third party practice. In the first place, that certainly could not be done with reference to the nineteen checks the originals of which were lost and not produced in court. The endorsers on them could not be ascertained.

In the second place, the appellants themselves could have sued the endorsers and have no right to complain that appellee did not do so.

Farmers' State Bank v. U. S. (C.C.A. 5th, 1932) 62 F. (2d) 178, 179.
Gustin-Bacon Mfg. Co. v. First National Bank (1922) 306 Ill. 179, 137 N.E. 793, 795.
U. S. v. National City Bank (D.C. N.Y., 1939) 28 F. Supp. 144, 149.

MISSING ORIGINALS OF NINETEEN CHECKS

Neither the nineteenth check listed on page 231 of the Record nor a carbon copy thereof was placed in evidence. None of the originals of the first eighteen checks listed on that page were placed in evidence. Carbon copies of them were placed in evidence (Ex. 2) over appellee's objection (R. 27, 172). A sample of

one of these carbon copies appears on page 173 of the record.

Section 69-505, Oregon Compiled Laws Annotated, enacted long prior to the date of any check here involved, provides:

> "The instrument must be exhibited to the person from whom payment is demanded, and when it is paid must be delivered up to the party paying it."

PROXIMATE CAUSE

The principle of equity and good conscience is the deciding factor in all cases where subrogation is allowed, whether it be by assignment or not. The loss must always fall where the proximate cause rests.

United States Guarantee Co. v. Elkins (C.C.A. 3rd, 1939) 106 F. (2d) 136, 137

> "The immediate and proximate cause of the loss was the forged endorsement of the check, specifically covered by the Forgery Bond."

American Bonding Co. v. Welts (C.C.A. 9th, 1912) 193 Fed. 978, 980

> "From the averments of the bills in these cases it is clear that the proximate cause of the county's loss and of the resultant loss to the appellant was the malfeasance of the auditor, for whose official honesty and faithfulness the appellant had bound itself."

To the same effect are:

Meyers v. Bank of America, 11 Cal. (2d) 92, 77 P. (2d) 1084, 1089.

United States Fidelity & Guaranty Co. v. Title Guaranty & Trust Co., (D.C. Md.) 200 Fed. 443, 449.
Commonwealth v. Farmers Deposit Bank (1936) 264 Ky. 839, 95 S.W. (2d) 793, 795-6.

CASES CITED BY APPELLANTS

A number of cases relied upon by appellants turned on the question of the bank's negligence, a different situation than that presented here. The action there was ex delicto and not on implied contract. Appellants have expressly stated in their brief that they rely on implied contract.

To hold a bank liable in an action ex delicto it is necessary to prove that the bank was a joint tort-feasor, i.e., that the bank had knowledge of the fraud.

Union Guardian Trust Co. v. First Nat. Bank-Detroit (1935) 271 Mich. 323, 259 N.W. 912, 916.
Commercial Sav. Bank v. National Surety Co. (C.C.A. 6th, 1923) 294 Fed. 261, 263-4.
Bank of Vass v. Arkenburgh (C.C.A. 4th, 1932) 55 F. (2d) 130, 132.
Quanah v. Wichita State Bank (Sup. Ct. Tex., 1936) 93 S.W. (2d) 701, 704.

Los Angeles Inv. Co. v. Home Sav. Bank, 180 Cal. 601, 182 Pac. 293

cited by appellants on pages 18, 24, 26, 29, 32, 38 and 39 of their brief, was an action by the depositor, not by an insurer, and the same is true of

Detroit Piston Ring Co. v. Wayne County and Home Savings Bank, 252 Mich. 163, 233 N. W. 185.

United States v. National Bank of Commerce (C.C.A. 9th) 205 Fed. 433.
Board of Education v. National Union Bank, 16 N.J.M. 50; 196 Atl. 352.

The cases of:

Shipman v. Bank of State of New York, 126 N.Y. 318, 27 N.E. 371

(cited on pages 16, 20, 25, 30 and 40 of appellants' brief) and

American Sash & Door Co. v. Commerce Trust Co., 332 Mo. 98, 56 S.W. (2d) 1,034

(cited on pages 18, 26, 29, 33 and 38 of appellants' brief) were actions by depositors, not by insurers, and in addition in neither case had the depositor entrusted to the wrongdoer, nor did the wrongdoer have, anything to do with the preparation or execution of the checks. In the case at bar Crowe prepared the checks for execution and was entrusted with delivery of them following execution.

The court in

First National Bank v. United States National Bank, 100 Or. 264, 197 Pac. 547, 557,

also cited by appellants, found that the equities of the defendant cashing bank were superior to those of the plaintiff drawee bank.

In an effort to escape the local law as exemplified by

American Central Insurance Co. v. Weller, 106 Or. 494, 212 Pac. 803

appellants, over pages 64-67 attack that case. The essence of the Weller case is that the plaintiff-insurer by separate and independent contract, insured the car against conversion and did not insure the balance of the debt due under the separate and independent conditional sales contract. The Weller opinion states that, while the facts were different, the principles of

Milwaukee Mechanics' Ins. Co. v. Ramsey (1915) 76 Or. 570, 149 Pac. 542.

were applicable.

In the Ramsey case the plaintiff fire insurer had, upon destruction of the building, paid the insurance money to the mortgagee as it was legally obligated to do. It then sued the mortgagor to recover the amount of this payment but was denied recovery in both the trial court and the supreme court. The essence of the decision, like that of the Weller case, is again separate and independent contractual liabilities, the court stating on page 544:

> "It did not insure the debt. It insured the building. * * * The plaintiff did not pay Ramsey's debt, and hence has no privity with that obligation entitling it to subrogation."

We have heretofore in this brief quoted the insuring clauses of each of the policies involved. They show that it is the honesty of the employee which is insured, not any specific checks or any specific debt. Interior would have had claims against each of the insurers for any dishonest act on the part of Crowe during the course of his employment and which resulted in loss to Interior.

Denial of recovery on the said theory of separate and independent contractual obligations followed in each of the following cases:

Bowles v. Gantenbein (1917) 83 Or. 510, 163 Pac. 308, 163 Pac. 1163, 1165

Plaintiffs were sureties for the faithful performance of a lease by the lessee who, by defaulting, compelled payment of some rentals by plaintiffs. Defendant held a contract debt against the lessee. He sued thereon and attached. Claiming to be subrogated to the rights of the lessor, plaintiffs sued the defendant to enjoin prosecution of his action and to discharge his attachment. In refusing to do this the court said:

> "In brief, the defendant holds a contract debt against the company. Its obligation to the plaintiffs is likewise upon contract. The two are in the same class. There is nothing in either claim to give one preference over the other. Where the equities are equal, the law will prevail."

Underwood v. Metropolitan Nat'l. Bank, 144 U. S. 669, 12 S. Ct. 784, 36 L. Ed. 586, 590.
New York Title & Mortgage Co. v. First National Bank (C.C.A. 8th, 1931) 51 F. (2d) 485, 487.
American Bonding Co. v. First National Bank (Ky. A., 1905) 27 Ky. L. 393, 85 S.W. 190.
Louisville Trust Co. v. Royal Indemnity Co. (Ky. A., 1929) 230 Ky. 482, 20 S.W. (2d) 71.

See also

Plate Glass Underwriters' Mut. Ins. Co. v. Ridgewood Realty Co. (1925) 219 Mo. App. 186, 269 S.W. 659, 662

wherein it is stated:

> "The insurance contract was one solely between the two parties thereto, and the insurance company only paid what it contracted primarily to do; but now, notwithstanding it still retains the premiums or the benefit of its contract, it seeks reimbursement from the landlord on the basis that the latter, under a wholly separate and independent contract, should have done so. We see no basis of subrogation arising out of the circumstances herein, and are of the opinion that the subrogation clause in the insurance contract only applies to circumstances in which the law creates the right of subrogation. The plaintiff insured the property itself, not a debt due the tenant. Havens v. Germania Ins. Co., 135 Mo. 649, 658, 659, 37 S.W. 497. The mere fact that the tenant might thus have two sources to which he could look for repair or reimbursement does not give the plaintiff the right to be subrogated to that right as to one of such sources." Citing cases.

United States Fidelity & Guaranty Co. v. Wooldridge, 268 U.S. 234, 45 S. Ct. 489, 69 L. Ed. 932.

Had appellants not paid Interior in full, Interior might have been able to make claim against appellee for the deficiency, but such claim would be predicated upon the separate contract between Interior and appellee. The situation would be much like that in

Western Surety Co. v. Walter (1921) 44 S.D. 112, 182 N.W. 635

where plaintiff had bonded a county treasurer and defendants, the then deceased treasurer's widow, father and brothers (see *177 N.W. 804*) had given the county their note to cover the defalcations. The court said on page 637:

> "In other words, we have a case where one party has entered into a collateral undertaking to secure or indemnify another against the results of official misconduct; after there has been official misconduct other parties give to the injured party a note, not to secure the payment of the undertaking given by the wrongdoer and on which the other party is a surety, but to secure the payment of any loss which the injured party may eventually suffer because of the wrongdoing."

CONCLUSION

We respectfully submit that both under the local law, which the trial court was obliged to apply under the doctrine of the Erie case, and under the majority and better law in effect over the nation, the trial court's opinion, findings and conclusions and judgment were correct and should be affirmed.

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